IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 111

HARRY F. DOYLE and LUCY J. DOYLE
(Husband and Wife),
Petitioners,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONERS' REPLY BRIEF TO RESPONDENT'S BRIEF IN OPPOSITION.

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1. The Respondent's brief, in opposition, proceeds on the erroneous theory that income is taxable in the year in which some court may classify it, or determine its status, and not in the year in which it was actually "derived." The Act taxes income when it is "derived." Neither the language of the Act nor its spirit justifies the attempt to tax in a later year "income derived" in an earlier year, merely because some court may judicially announce the "classification or status" of the income in the later year. The statute would have to be worded differently to permit the postponement by litigation or anticipated litigation,

of taxation of income previously "derived" as contended for by the respondent.

When would it be proper to tax this income if Petitioners' suit had never been brought?

2. We insist vigorously and with sincere confidence that there is definitely a *bona fide* conflict between the decision below and the decision of the United States Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *North Jersey Title Ins. Co.*, 79 Fed. (2d) 492.

We insist that what is important as to the existence of a conflict here, is that litigation, which determined the "classification or status of the cash payment" was involved in both cases. In one case litigation was held to postpone taxability, and in the other it was held exactly the opposite.

Respondent's conclusion that there is no conflict is predicated on fallacious reasoning and an obvious misconception of what was involved in the *North Jersey* case. Respondent says (Res. Br. 6):

> "That case did not involve the question, here presented, as to the effect of a subsequent judicial determination, which for the first time converts into profit what had previously been a return of capital."

In both cases a cash down payment had been made and suit for specific performance followed. In both cases, it was not known until the litigation terminated whether *all* of the cash payment would be regarded as *income* or a *part* would be regarded as *return of capital.* We do not believe that the Court decision in either case "converts into" one thing something which had previously been "something else." But we insist that if litigation in the one case leaves income or capital to be converted into capital or income by the Court, the same is true in both cases.

We most vigorously insist also that the *North Jersey* case *did* involve "the precise question here presented, as to the effect of a subsequent judicial determination, which for the first time" decided what portion of the down payment was profit and what portion of it was return of capital. In both cases the "classification or status of the cash payment" was not determined *judicially* until the Court rendered its decision. The status of the fund would be equally uncertain and the Court's decision would have had the same effect in both cases as to the part of the down payment which could be "converted into" profit or return of capital, either under the cash basis or under the accrual basis. In none of these cases referred to in the petition does this difference in accounting methods become material. See *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, 423, 52 S. Ct. 614, 615.

Respondent has offered no reason whatsoever as to why these methods of accounting should be a material factor here. It must be assumed therefore that there are no such reasons applicable here, otherwise Respondent would have attempted some answer to Petitioners' contrary arguments. (See Petition, bottom p. 7 and top of p. 8).

To say (Res. Br. 7), that the Court in the *North Jersey* case was not concerned with "the classification or status of the cash payment" merely avoids the true issue. In that case, as in the instant case, the cash payment contained a portion of capital and a portion of profit, and should specific performance have not been decreed, as in the instant case, all the cash payment and no more would have been income. If specific performance were to be decreed, in both cases the cash payment would be "converted" into return of capital in part and part would remain profit. In *both cases,* until the Court rendered its decision, it was not known what part of the cash payment would be profit and what part would be return of capital.

Clearly, in both cases, whether the Court decreed specific performance or forfeiture, the "classification or status of the cash payment" as income or capital was not determined until its decision was rendered.

If, as contended by the Respondent, the income is taxable in the year in which the "classification or status of the cash payment" is determined by a Court decision, Respondent's statement (Res. Br. 7) that "in the *North Jersey* case the Court was not concerned with the classification or status of the cash payment" is inaccurate and untrue. The conflict is clear.

Respondent's denial of conflict between the decision below and the decision of the United States Circuit Court of Appeals for the Fifth Circuit, in *Baird* v. *United States,* 65 Fed. (2d) 911, is entitled to no weight because it is predicated on a misstatement of fact indispensable to Respondent's tenuous ground of distinction. Respondent states (Res. Br. 8) as to the *Baird* case:

> "The Court there recognized that the payment could not be classified as income in the year in which it was actually received (1919) but decided that upon the facts presented, the status became fixed in the succeeding year (1920) when, following the default, *the seller elected to declare the payment forfeited.*" (Italics ours.)

The truth which Respondent misstated is that, in the *Baird* case, the seller *did not* elect to declare the payment forfeited until *in 1921* when the suit was brought, which, in that case resulted in annulling the contract. The truth is also that under the agreement in the *Baird* case, the seller had only fifteen days from the date of default (February 8, 1920) within which, by written notice, he was required to exercise his *election* to declare the contract forfeited. (See pages 8 and 9 of Petition.) This

he actually failed to do and the suit he eventually brought in 1921, later determined that only $150,000.00 of the $500,000.00 received by him in 1919 could be retained by him. In the *Baird* case, *supra,* the Circuit Court of Appeals held the seller's income taxable in 1920, not, as Respondent states, because it was *then* (1920) that "the seller elected to declare the payment forfeited," *which is exactly what he did not do then,* but in truth because on February 8th, 1920, the seller's rights arose to keep $150,000.00 of the payment as the result of Flannery's failure to go through with the contract which the seller was ready to perform. The Seller's election in the *Baird* case, as in the instant case, did not occur *until suit was brought.* However, the Court in the *Baird* case ignored such time of election in 1921 and held the income was derived in 1920, the year of default. The Circuit Court affirmed the District Court's specific holding that the "choice" of the seller "was not exercised until January, 1921, when he determined to disregard that option and sued for the dissolution of the contract * * *." (3 Fed. Supp. 947, 949). The conflict here is clear also.

Respondent's denial of conflict (Res. Br. 8) between the decision below and that of this Honorable Court in *North American Oil Consolidated* v. *Burnet,* 286 U. S. 417, completely disregards the fundamental principle and raises "a distinction without a difference." The question there, as here, was as to the effect of *litigation* on *income* already "derived" and received. The fact that the income there was merely called "earnings" and that here the income is called "profits" is Respondent's only excuse for distinguishing the cases. Obviously, both "earnings" and "profits" are "income" and the distinction seems wholly irrelevant and pointless. No reason for this supposed distinction is offered. However, some of the "other decisions" cited in the Petition (Pet. 11, 12) referred to by Respondent (Res. Br. p. 8) as being "similarly distinguishable" involve "profits" from sales rather than

"earnings." See for example *Board* v. *Commissioner,* 51 Fed. (2d) 73, 75 (1931 C. C. A. 6), Cer. Den. 284, U. S. 658, 52 S. Ct. 35; G. C. M. 16730 XV—1 C. B. 179; *Baird* v. *United States,* 65 Fed. (2d) 911; and in *Blum* v. *Helvering,* 74 Fed. (2d) 482 (1934), the Court of Appeals for the D. C. in paraphrasing the words of this Honorable Court in *North American Oil Consolidated* v. *Barnet, supra,* actually substituted the word "*profits*" for the word "*earnings*" to make the question apply to the situation there, clearly recognizing that the principle is fundamental and applies whether earnings or profits are involved. The case of *Commissioner* v. *North Jersey Title Ins. Co., supra,* also involved "profits" as distinguished from "earnings."

The Respondent does not deny Petitioners assertion (Pet. 9, 10) that the question herein involved is one of substantial and general importance in the administration of the income tax laws. Nor does the Respondent deny the existence of uncertainty and confusion as to the extent to which the termination of litigation affects the taxability of income already received and held under claim of right. This seems tantamount to an admission of the general importance of the fundamental question herein involved and of the uncertainty and confusion existing in this regard and justifies the granting of Certiorari by this Honorable Court.

No attempt has been made by Respondent to answer Petitioner's argument (Pet. 13 to 15) that income is not derived or created by Court decisions.

It is earnestly prayed, therefore, that the Writ of Certiorari be granted.

Respectfully submitted,

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June 29, 1940.